



CHAIR  
**BILL CAMPBELL**  
Supervisor  
Third District

March 14, 2007

VICE CHAIR  
**JOHN WITHERS**  
Director  
Irvine Ranch Water District

**TO:** Local Agency Formation Commission

**FROM:** Executive Officer  
Assistant Executive Officer

**ROBERT BOUER**  
Councilmember  
City of Laguna Woods

**SUBJECT:** FY 2005-2006 LAFCO Audit

**PETER HERZOG**  
Councilmember  
City of Lake Forest

On June 30, 2005, the Commission ratified a contract with the certified public accounting firm of Moreland & Associates, Inc. to perform annual audits of LAFCO's financial statements. A draft of the audit report for FY 2005-2006 has been completed and is attached for your review.

**JOHN MOORLACH**  
Supervisor  
2<sup>nd</sup> District

The audit consists of three parts:

**ARLENE SCHAFER**  
Director  
Costa Mesa  
Sanitary District

- **Transmittal Letter** – an audit report cover letter from Moreland & Associates, Inc. outlining the auditor's professional responsibilities and accounting policies (Attachment 1).
- **Orange LAFCO Financial Statements** – an independent review of the government activities and each major fund of Orange County LAFCO for FY 2005-2006 (Attachment 2).
- **Government Auditing Standards** – a report identifying and disclosing the auditor's compliance with current government auditing standards.

ALTERNATE  
**PAT BATES**  
Supervisor  
5<sup>th</sup> District

ALTERNATE  
**PATSY MARSHALL**  
Councilmember  
City of Buena Park

ALTERNATE  
**RHONDA MCCUNE**  
Representative of  
General Public

ALTERNATE  
**CHARLEY WILSON**  
Director  
Santa Margarita  
Water District

**JOYCE CROTHWAITE**  
Executive Officer

During the audit process, the independent auditor did not identify any issues relating to LAFCO's accounting procedures, current internal financial controls or office procedures. Because no irregularities were found, the auditor did not issue a "management letter" which is used to identify issues of concern.

Commission Policy Requires Auditor Change for FY 2006-2007 Audit

The accounting firm of Moreland & Associates, Inc. has performed annual financial audits for LAFCO during the past five years: FYs 2001-2002, 2002-2003, 2003-2004, 2004-2005, and 2005-2006. The Commission's adopted Accounting & Financial Policies and Procedures require that auditors be changed every five years to ensure competitive pricing and a high quality of service. Accordingly, staff will be conducting a Request for Proposal (RFP) process in the coming months to select a new auditor to review LAFCO's FY 06-07 financial statements.

**Recommendation**

Staff recommends that the Commission:

1. Receive and file the Moreland & Associates transmittal letter, the independent review of Orange LAFCO's financial statements, and the auditor's report of compliance with government auditing standards for FY 2005-2006.

Respectfully submitted,

  
JOYCE CROSTHWAITE

  
BOB ALDRICH

Attachments:

1. *Moreland & Associates, Inc. - Transmittal Letter*
2. *LAFCO 2005-2006 Financial Statements*
3. *Moreland & Associates, Inc. - Compliance with Government Auditing Standards Letter*



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November 30, 2006

Members of the Orange County  
Local Agency Formation Commission

Report on Internal Control Over Financial Reporting and on  
Compliance and Other Matters Based on an Audit of Financial Statements  
Performed in Accordance With Government Auditing Standards

We have audited the financial statements of the governmental activities and each major fund of the Orange County Local Agency Formation Commission (Commission) as of and for the year ended June 30, 2006, which collectively comprise the Commission's basic financial statements, and have issued our report thereon dated November 30, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Orange County Local Agency Formation Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Member of the  
Orange County Local Agency  
Formation Commission  
November 30, 2006  
Page 2

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Orange County Local Agency Formation Commission's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of the Commission members and management of the Orange County Local Agency Formation Commission and is not intended to be and should not be used by anyone other than these specified parties.

*Woodward & Associates, Inc.*

**ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION**

**Financial Statements**

**June 30, 2006**

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Financial Statements  
June 30, 2006

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November 30, 2006

Orange County Local Agency  
Formation Commission

Independent Auditors' Report

We have audited the accompanying financial statements of the governmental activities and each major fund of the Orange County Local Agency Formation Commission, (Commission), as of and for the year ended June 30, 2006, which collectively comprise the Commission's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Orange County Local Agency Formation Commission as of June 30, 2006, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated November 30, 2006 on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The management's discussion and analysis and other required supplementary information identified in the accompanying table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Moreland & Associates, Inc.*



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## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the financial performance of the Orange County Local Agency Formation Commission provides an overview of the Commission's financial activities for the fiscal year ended June 30, 2006. Please read it in conjunction with the financial statements identified in the accompanying table of contents.

### Using the Accompanying Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the Commission as a whole and present a longer-term view of the Commission's finances. Also included in the accompanying report are fund financial statements. For governmental activities, the fund financial statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the Commission's operations in more detail than the government-wide statements by providing information about the Commission's most significant funds.

## OVERVIEW OF THE FINANCIAL STATEMENTS

The annual report consists of four parts – *management's discussion and analysis* (this section), the *basic financial statements, required supplementary information*, and an optional section that presents *combining statements* for nonmajor governmental funds. The basic financial statements include two kinds of statements that present different views of the Commission:

The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the Commission's overall financial status. The remaining statements are *fund financial statements* that focus on *individual parts* of the Commission government, reporting the Commission's operations in *more detail* than the government-wide statements.

The financial statements also include *notes* that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that provided additional financial and budgetary information.

### Reporting the Commission as a Whole

The accompanying **government-wide financial statements** include two statements that present financial data for the Commission as a whole. One of the most important questions asked about the Commission's finances is, "Is the Commission as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the Commission as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Commission's net assets and changes in them. You can think of the Commission's net assets – the difference between assets and liabilities – as one way to measure the Commission's financial health, or *financial position*. Over time, *increases and decreases* in the Commission's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other nonfinancial factors, such as changes in the Commission's revenues, to assess the *overall health* of the Commission.

### Reporting the Commission's Major Funds

The **fund financial statements** provide detailed information about the Commission's most significant funds – not the Commission as a whole. Some funds are required to be established by State law or by bond covenants. However, the Commission establishes many other funds to help it control and manage money for particular purposes or to show that it is meeting administrative responsibilities for using certain revenues.

*Governmental funds* – All of the Commission's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *current financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the Commission's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Commission's programs. We describe the relationship or differences between *governmental activities* (reported in the Statement of Net Assets and the Statement of Activities) and *governmental funds* in a reconciliation following the fund financial statements.

### GOVERNMENT-WIDE FINANCIAL STATEMENTS

A summary of the government-wide *statement of net assets* follows:

Table 1 Net Assets – Governmental Activities			
	<u>2006</u>	<u>2005</u>	<u>Difference</u>
<u>Assets</u>			
Capital assets, net	\$ 47,512	\$ 58,463	\$ (10,951)
Other assets	<u>566,655</u>	<u>559,710</u>	<u>6,945</u>
Total assets	<u>614,167</u>	<u>618,173</u>	<u>(4,006)</u>
<u>Liabilities</u>			
Long-term liabilities	34,296	35,493	(1,197)
Other liabilities	<u>41,661</u>	<u>63,295</u>	<u>(21,634)</u>
Total liabilities	<u>75,957</u>	<u>98,788</u>	<u>(22,831)</u>
<u>Net assets</u>			
Invested in capital assets	47,512	58,463	(10,951)
Unrestricted	<u>490,698</u>	<u>460,922</u>	<u>29,776</u>
Total Net Assets	<u>\$538,210</u>	<u>\$519,385</u>	<u>\$ 18,825</u>

A summary of the government-wide *statement of activities* follows:

Table 2  
Changes in Net Assets – Governmental Activities

	<u>2006</u>	<u>2005</u>	<u>Difference</u>
<u>Revenues</u>			
Program Revenues:			
Charges for services	\$1,027,006	\$1,037,197	\$ (10,191)
General Revenues:			
Interest	18,072	10,593	7,479
Other	<u>23,999</u>	<u>9,800</u>	<u>14,199</u>
Total Revenues	<u>1,069,077</u>	<u>1,057,590</u>	<u>11,487</u>
<u>Expenses</u>			
Program Expenses:			
Salaries and benefits	710,573	691,150	19,423
Services and supplies	<u>339,679</u>	<u>343,462</u>	<u>(3,783)</u>
Total Expenses	<u>1,050,252</u>	<u>1,034,612</u>	<u>15,640</u>
Change in Net Assets	18,825	22,978	(4,153)
Net Assets at Beginning of Year	<u>519,385</u>	<u>496,407</u>	<u>22,978</u>
Net Assets at End of Year	<u>\$ 538,210</u>	<u>\$ 519,385</u>	<u>\$ 18,825</u>

The increase or decrease in net assets can provide an indication as to whether the overall financial position of the Commission improved or deteriorated during the year. Net assets of the Commission increased by \$18,825.

The reasons for significant changes in the revenues and expenses of the Commissions' governmental activities presented above are as follows:

- The Commission was able to keep expenses within the approved budget.
- The major revenue source during the year was the Commission's apportionment in the amount of \$930,920. Charges for services declined by \$101,803 from the prior year due to a special one time projects in fiscal year ending June 30, 2004.
- The major expense during the year was salaries and benefits totaling \$710,573. Salaries and benefits increased \$19,423 (21%) since the prior year primarily due to increases in OCERS retirement contributions and increases in health insurance.

## MAJOR FUNDS

As noted earlier, the Commission uses fund accounting to provide proper financial management of the Commission's resources and to demonstrate compliance with finance-related legal requirements.

**Major Governmental Funds.** The **General Fund** is the chief operating fund of the Commission. At the end of the current fiscal year, unreserved fund balance of the general fund was \$9,302 compared to \$99,827 in fiscal year ended June 30, 2005. Total fund balance in the general fund at June 30, 2006 was \$302,580, which is a \$25,702 increase from the prior year.

General Fund revenues remained consistent from the prior year. General Fund salaries and benefits increased due to an increase in the OCERS required retirement contribution and an increase in health benefits.

## GENERAL FUND BUDGET

Major deviations between the budget of the General Fund and its actual operating results were as follows:

- Charges for services exceeded the budget by \$4,792 due to an unexpected increase in applications for city and special district annexations. Total revenues exceeded budgeted revenues by \$15,177.
- Salaries and benefits exceeded the budget by \$9,448 because the County of Orange's estimates of benefits were lower than actual.
- Services and supplies were less than budgeted because the Commission utilized less professional services than anticipated.

## CAPITAL ASSETS

### Capital Assets – Governmental Activities (net of depreciation)

	<u>2006</u>	<u>2005</u>	<u>Difference</u>
Furniture and fixtures	\$ 30,601	\$ 30,601	-
Equipment	37,127	32,947	\$4,180
Leasehold improvements	<u>40,361</u>	<u>40,361</u>	<u>-</u>
Total	<u>\$108,089</u>	<u>\$103,909</u>	<u>\$4,180</u>

There were only minor additions to capital assets for the year ended June 30, 2006.

### LONG-TERM LIABILITIES

	<u>2006</u>	<u>2005</u>	<u>Difference</u>
Compensated absences	<u>\$34,296</u>	<u>\$35,493</u>	\$(1,197)

Additional information on the Commission's capital assets and long-term liabilities can be found in notes 3 and 5 to the accompanying financial statements.

#### ***Contacting the Commission's Financial Management***

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the Commission's finances and to show the Commission's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Executive Officer at 12 Civic Center Plaza, Room 235, Santa Ana, CA 92701

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Statement of Net Assets  
June 30, 2006

	<u>Governmental Activities</u>
<u>Assets</u>	
Cash and investments	\$ 447,313
Due from other governments	2,776
Prepaid expenses	116,227
Interest receivable	339
Capital assets net of accumulated depreciation	<u>47,512</u>
Total Assets	<u>614,167</u>
 <u>Liabilities</u>	
Accounts payable and accrued liabilities	31,544
Unearned revenue	1,461
Due to other governments	8,656
Noncurrent Liabilities:	
Due in more than one year	<u>34,296</u>
Total Liabilities	<u>75,957</u>
 <u>Net Assets</u>	
Invested in capital assets	47,512
Unrestricted	<u>490,698</u>
Total Net Assets	<u><u>\$ 538,210</u></u>

See Accompanying Notes to Financial Statements.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Statement of Activities  
For the Year Ended June 30, 2006

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenue Charges for Services</u>	<u>Net (Expense) Revenue and Change in Net Assets Governmental Activities</u>
Governmental Activities:			
Salaries and benefits	\$ 710,573	\$ 1,027,006	\$ 316,433
Services and supplies	339,679		(339,679)
Total Governmental Activities	<u>\$ 1,050,252</u>	<u>\$ 1,027,006</u>	<u>(23,246)</u>
General Revenues:			
Interest			18,072
Other			23,999
Total General Revenues			<u>42,071</u>
Change in Net Assets			18,825
Net Assets - Beginning of Year			<u>519,385</u>
Net Assets - End of Year			<u>\$ 538,210</u>

See Accompanying Notes to Financial Statements.



ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Balance Sheet  
June 30, 2006

	General Fund	Special Revenue Fund	Total
<u>Assets</u>			
Cash and investments	\$ 224,899	\$ 222,414	\$ 447,313
Due from other governments	2,776		2,776
Prepaid expenses	116,227		116,227
Interest receivable	339		339
	<hr/>	<hr/>	<hr/>
Total Assets	<u>\$ 344,241</u>	<u>\$ 222,414</u>	<u>\$ 566,655</u>
<u>Liabilities</u>			
Liabilities:			
Accounts payable and accrued liabilities	\$ 31,544		\$ 31,544
Deferred revenue	1,461		1,461
Due to other governments	8,656		8,656
	<hr/>	<hr/>	<hr/>
Total Liabilities	<u>41,661</u>	<hr/>	<u>41,661</u>
<u>Fund Balances</u>			
Reserved for litigation	75,000		75,000
Reserved for encumbrances	1,851		1,851
Reserved for petty cash	200		200
Reserved for prepaid expenses	116,227		116,227
Reserved for special projects		222,414	222,414
Reserved for contingency	100,000		100,000
Undesignated	9,302		9,302
	<hr/>	<hr/>	<hr/>
Total Fund Balances	<u>302,580</u>	<u>222,414</u>	<u>524,994</u>
	<hr/>	<hr/>	<hr/>
Total Liabilities and Fund Balances	<u>\$ 344,241</u>	<u>\$ 222,414</u>	<u>\$ 566,655</u>

See Accompanying Notes to Financial Statements.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Reconciliation of the Governmental Funds Balance Sheet  
to the Statement of Net Assets  
June 30, 2006

Fund balances for governmental funds	\$ 524,994
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Amounts reported for governmental activities in the Statement of Net Assets are different because:

Capital assets used in governmental activities are not current financial resources and therefore are not reported in the Governmental Funds Balance sheet.	47,512
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Long-term liabilities, such as compensated absences are not due and payable in the current period and therefore are not reported in the Governmental Funds Balance sheet.	<u>(34,296)</u>
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Net Assets of Governmental Activities	<u><u>\$ 538,210</u></u>
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See Accompanying Notes to Financial Statements.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Statement of Revenues, Expenditures and  
Changes in Fund Balances  
For the Year Ended June 30, 2006

	General Fund	Special Revenue Fund	Total
Revenues:			
Charges for services:			
Assessment	\$ 986,917		\$ 986,917
Filing fees	22,650	\$ 17,439	40,089
Interest	18,072		18,072
Other	6,313	17,686	23,999
	<u>1,033,952</u>	<u>35,125</u>	<u>1,069,077</u>
Total Revenues			
Expenditures:			
Salaries and benefits	711,770		711,770
Services and supplies	296,480	32,248	328,728
	<u>1,008,250</u>	<u>32,248</u>	<u>1,040,498</u>
Total Expenditures			
Excess (Deficiency) of Revenues Over (Under) Expenditures	25,702	2,877	28,579
Fund Balances - Beginning of Year	<u>276,878</u>	<u>219,537</u>	<u>496,415</u>
Fund Balances - End of Year	<u><u>\$ 302,580</u></u>	<u><u>\$ 222,414</u></u>	<u><u>\$ 524,994</u></u>

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances  
Governmental Funds to the Statement of Activities  
For the Year Ended June 30, 2006

Net change in fund balances - total governmental funds: \$ 28,579

Amounts reported for governmental activities in the Statement of Activities  
are different because:

Governmental Funds report capital acquisitions as expenditures.  
However, in the Statement of Activities, the costs of capital assets  
included in services and supplies is allocated over their estimated useful  
lives and reported as depreciation expense.

Capital outlay	\$ 4,180
Depreciation	<u>(15,131)</u>

(10,951)

Long-term liabilities, such as compensated absences are not due and  
payable in the current period and therefore are not reported in the  
Statement of Revenues, Expenditures and Changes in Fund Balance.

1,197

Change in Net Assets of Governmental Activities

\$ 18,825

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ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements  
June 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Orange County Local Agency Formation Commission (Commission) conform to generally accepted accounting principles as applicable to governments. The following is a summary of the significant policies.

A. Description of the Reporting Entity

Following the end of World War II, California entered a new era of demographic growth and diversity, and economic development. With this growth came the need for housing, jobs and public services. To provide for these services, California experienced a wave of newly formed cities and special districts, but with little forethought as to how the new agencies should plan for services. The lack of coordination and adequate planning for future governance led to a multitude of overlapping, inefficient jurisdictional and service boundaries.

In 1963, the State Legislature created Local Agency Formation Commissions (Commissions) to help direct and coordinate California's growth in a logical, efficient, and orderly manner. Each county within California is required to have a Commission. The Commissions are charged with the responsibility of making difficult decisions on proposals for new cities and special districts, spheres of influence, consolidations, and annexations.

Prior to July 1, 2001, the Commission was a department of the County of Orange. The Commission has separated from the County and is now independent. The Commission's governing board consists of seven appointed board members. Two members are selected by the Orange County Board of Supervisors from their own membership, two are selected by the cities in the County, two are selected from special districts by the independent special district selection committee and one member is selected to represent the general public, who is appointed by the other members of the Commission.

Funding for the Commission operations is equally shared by the County, the 34 Orange County cities and the 26 independent special districts. Although the County of Orange contributes one-third of the Commission funding, the Commission is an independent agency and its budget is not subject to County approval. The Commission is staffed by a total of six full-time staff.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements (Continued)  
June 30, 2006

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the activities of the Commission.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include charges for services that are restricted to meeting the operational or capital requirements of a particular function or segment. Use of money and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

The Commission reports the following major governmental funds:

The General Fund is used to account for resources traditionally associated with the government, which are not required legally or by sound financial management to be accounted for in another fund.

The Special Revenue Fund is used to account for resources derived from the specific revenue sources which are usually required by law or administrative regulation to be accounted for in separate funds. The Commission utilizes this fund to account for the different project areas.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of the related cash flows.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements (Continued)  
June 30, 2006

generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences are not recognized until paid.

Charges for services and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as program revenues include charges to members. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

When both restricted and unrestricted resources are available for use, it is the Commission's policy to use restricted resources first, and then use unrestricted resources as needed.

**D. Capital Assets**

Capital assets are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by the Commission as assets with an initial cost of more than \$500. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Capital assets of the Commission are depreciated using the straight-line method over the following estimated useful lives:

Furniture & fixtures	10 years
Equipment	2 to 5 years
Leasehold improvements	Life of Lease



ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements (Continued)  
June 30, 2006

E. Investments

Investments are stated at fair value (the value at which a financial instrument could be exchanged, other than in a forced or liquidation sale), in accordance with Government Accounting Standards Board (GASB) Statement 31.

F. Budgets and Budgetary Accounting

The Commission established accounting control through formal adoption of an annual budget for the General Fund. The budget is prepared on a basis consistent with generally accepted accounting principles. The adopted budget can be amended by the Commission to change both appropriations and estimated revenues as unforeseen circumstances come to management's attention. Increases and decreases in revenue and appropriations and transfers between funds require Commission's approval. However, the Chief Executive Officer may authorize changes within funds. Expenditures may not exceed total appropriations at the individual fund level. It is the practice of the Commission's management to review the budget mid-year and, if necessary, recommend changes to the Commission. Budgets are not prepared for the Special Revenue Fund.

2. CASH AND INVESTMENTS

Cash and investments as of June 30, 2006 consist of the following:

Petty cash	\$ 200
Demand deposits	<u>447,113</u>
Total Cash and Investments	<u><u>\$ 447,313</u></u>

Investments Authorized by the Commission's Investment Policy

The Commission's investment policy authorizes investments in the under-mentioned agencies/institutions:

- State Local Agency Investment Fund (LAIF).
- U.S. Government and Agencies obligations
- Negotiable Certificates of Deposit issued by a nationally or state chartered bank, a state or federal savings and loan association, or savings bank with ratings equivalent by Fitch to be F1 or better.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements (Continued)  
June 30, 2006

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Commission manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

As of June 30, 2006, the Commission had investments in the form of a bank savings account and as such it was not exposed to any interest rate risk as described above.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The bank balances are not subject to credit rating.

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Commission's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure Authority deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements (Continued)  
June 30, 2006

At June 30, 2006 \$330,124 the Commission's deposits with financial institutions in excess of federal depository insurance limits were held in collateralized accounts.

With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment insecurities through the use of mutual funds or government investment pools (such as LAIF).

3. CAPITAL ASSETS

Changes in the Capital Assets for the year ended June 30, 2006 were as follows:

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006
Furniture and fixtures	\$ 30,601			\$ 30,601
Equipment	32,947	\$ 4,180		37,127
Leasehold improvement	40,361			40,361
 Total Capital Assets	 103,909	 4,180		 108,089
 Accumulated depreciation	 (45,446)	 (15,131)		 (60,577)
 Total Capital Assets, Net	 \$ 58,463	 \$ (10,951)	 \$ -	 \$ 47,512

Depreciation expense of \$15,131 was charged to services and supplies.

4. INSURANCE

Insurance is provided on behalf of the commission by the County of Orange Insurance Policy. The Commission pays its pro-rata share of insurance costs to the County. For coverage limits see the County of Orange Comprehensive Annual Financial Report.

This report can be obtained at the Auditor-Controller County of Orange office located at Hall of Finance and Records, 12 Civic Center Plaza, Room 202, Santa Ana, CA 92702.

5. COMPENSATED ABSENCES

The Commission had compensated absences outstanding at June 30, 2006 in the amount of \$34,296.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements (Continued)  
June 30, 2006

6. RETIREMENT PLAN

Plan Description

The Commission participates in the Orange County Employees' Retirement System (OCERS), a cost-sharing multiple-employer, and defined benefit pension plan. OCERS was established in 1945 under the provisions of the County Employees Retirement Law of 1937, and provides members with retirement, death, disability, and cost-of-living benefits. The Commission's payroll of employees covered by OCERS was \$508,257 for the year ended June 30, 2006; the Commission's total payroll was \$516,262 in Fiscal Year 2005-2006. OCERS issues a publicly available financial report that includes financial statements and required supplementary information for the Commission. The report can be obtained from OCERS at 2223 Wellington Avenue, Santa Ana, CA 92701.

Funding

The OCERS pension plan covers substantially all full-time and part-time employees (over 20 hours per pay period) of the Orange County Local Agency Formation Commission, the County of Orange, and several other cities and special districts within the County. Each of the participating entities shares proportionally in all risks and costs. One actuarial valuation is performed of OCERS as a whole, and the same contribution rates apply to each participating entity. For 2006, the Commission's required contribution was 12.63%. The funding policy for participating agencies is to make periodic contributions to OCERS in amounts such that, when combined with employees' contributions and with investment income, will fully provide for all employees' benefits by the time they retire. The Commission's policy is to pay both the employer's contributions and the employees' contributions to the plan pursuant to Government Code Section 31581.1 and 31581.2, respectively.

Benefits

All of the Commission's full-time employees participate in OCERS. Employees who retire at or after age 50 with ten or more years of service are entitled to an annual retirement allowance. The amount of the retirement allowance is based upon the member's age at retirement, the member's "final compensation" as defined in Section 31462 of the Retirement Law of 1937, the total years of service under OCERS, and the employee's classification as a Tier I and Tier II member. Benefits fully vest on reaching five years of service. OCERS also provides death and disability benefits.

Contributions

The Commission pays the County of Orange for their pro-rata share of OCERS coverage. The total amount of OCERS contributions for the year ended June 30, 2006 from the Commission was \$104,021.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements (Continued)  
June 30, 2006

Three-year Trend Information

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
June 30, 2004	\$ 76,320	100%	\$-0-
June 30, 2005	88,460	100%	\$-0-
June 30, 2006	104,021	100%	\$-0-

7. OTHER POST-EMPLOYMENT BENEFITS

In addition to the retirement plan described in Note 6, the Commission provides a post-employment medical retirement plan for full-time employees. All full-time employees contribute one percent of their gross pay toward the medical retirement plan. Upon retirement, the retired employees are eligible to receive their benefit as a monthly credit towards the cost of the retired employees' medical insurance. The amount of the monthly benefit is based on the retiree's years of credited service. As of June 30, 2006, there were no retirees eligible to receive monthly retiree medical benefits. Employees who separate from the Commission prior to retirement age are eligible to receive their benefit as a lump sum payment. There were no payments made during Fiscal Year 2005-2006.

8. COMMITMENTS

The Commission is obligated under operating lease agreements for the rental of office space and various equipment. Future minimum lease payments under these operating leases are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 32,641
2008	33,625
2009	<u>34,630</u>
Total	<u>\$ 100,896</u>

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Notes to Financial Statements (Continued)  
June 30, 2006

Additionally, the rental agreement which is included in the County Services Agreement between the County of Orange and the Commission may be terminated by either party at any time. The total amount of rental payments for the year ended June 30, 2006 was \$31,208.

9. RELATED PARTY TRANSACTIONS

The Commission and the County of Orange (County) entered into a County Services Agreement to provide office space (see further disclosure at Note 8), liability and workers' compensation insurance, employee benefits administration, payroll, information technology support, and billing and collection services. The total amount paid by the Commission to the County for the year ended June 30, 2006 was \$60,483.

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## **Required Supplementary Information**



ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
General Fund  
Budgetary Comparison Schedule  
For the Year Ended June 30, 2006

	Original/ Final Budget	Actual	Variance Positive (Negative)
Revenues:			
Charges for services:			
Assessment	\$ 986,775	\$ 986,917	\$ 142
Filing fees	18,000	22,650	4,650
Interest	14,000	18,072	4,072
Other		6,313	6,313
	<u>1,018,775</u>	<u>1,033,952</u>	<u>15,177</u>
Total Revenues			
Expenditures:			
Salaries and benefits	702,322	711,770	(9,448)
Services and supplies	374,467	296,480	77,987
	<u>1,076,789</u>	<u>1,008,250</u>	<u>68,539</u>
Total Expenditures			
Net Change in Fund Balance	(58,014)	25,702	83,716
Fund Balances - Beginning of Year	<u>276,878</u>	<u>276,878</u>	
Fund Balances - End of Year	<u>\$ 218,864</u>	<u>\$ 302,580</u>	<u>\$ 83,716</u>

See Accompanying Note to Required Supplementary Information.

ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION  
Note to Required Supplementary Information  
June 30, 2006

1. Budgets and Budgetary Accounting

The Commission established accounting control through formal adoption of an annual budget for the General Fund. The budget is prepared on a basis consistent with generally accepted accounting principles. The adopted budget can be amended by the Commission to change both appropriations and estimated revenues as unforeseen circumstances come to management's attention. Increases and decreases in revenue and appropriations and transfers between funds require Commission's approval. However, the Chief Executive Officer may authorize changes within funds. Expenditures may not exceed total appropriations at the individual fund level. It is the practice of the Commission's management to review the budget mid-year and, if necessary, recommend changes to the Commission. Budgets are not prepared for the Special Revenue Fund.

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**ORANGE COUNTY  
LOCAL AGENCY FORMATION COMMISSION**

**Financial Statements**

**June 30, 2006**





1201 DOVE STREET, SUITE 680  
NEWPORT BEACH, CALIFORNIA 92660  
(949) 221-0025

570 RANCHEROS DRIVE, SUITE 260  
SAN MARCOS, CA 92069  
(760) 752-3390

November 30, 2006

Members of the Orange County  
Local Agency Formation Commission

We have audited the financial statements of the governmental activities and each major fund of the Orange County Local Agency Formation Commission (Commission) for the year ended June 30, 2006, which collectively comprise the Commission's basic financial statements, and have issued our report thereon dated November 30, 2006. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Generally Accepted Auditing Standards and Governmental Auditing Standards

Our responsibility as described by professional standards is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the basic financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Orange County Local Agency Formation Commission. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing the Commission's financial statements and our report thereon does not extend beyond financial information identified in our report, and we have no obligation to perform any procedures to corroborate other information contained in these documents. We have, however, read the other information included in the Commission's annual financial statements; and no matters came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or its manner or presentation, appearing in the financial statements.

### Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. We will advise management about the appropriateness of accounting policies and their application. The significant accounting policies of the Commission are described in Note I to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions during the year that were both significant and unusual, or transactions for which there is a lack of authoritative guidance or consensus.

### Management Judgments and Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based upon management's knowledge and experience about past and current events and assumptions about future events. We noted that the Commission's significant account balances are not dependent upon management's estimates.

### Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Orange County Local Agency Formation Commission's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Orange County Local Agency Formation Commission, either individually or in the aggregate, indicate matters that could have a significant effect on the Commission's financial reporting process.

### Disagreements With Management

There were no disagreements with management on financial accounting, reporting or auditing matters that, if not satisfactorily resolved, could be significant to the Commission's financial statements or to our auditors' report.

### Consultation With Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Members of the Orange County  
Local Agency Formation Commission  
November 30, 2006  
Page 3

Issues Discussed With Management Prior to Retention

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Commission's auditors. These discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our retention.

This information is intended solely for the information and use of the Commission members and management of the Orange County Local Agency Formation Commission and is not intended to be and should not be used by anyone other than these specified parties.

*Woodland & Associates, Inc.*